September 9, 2004

To: Council Committee for Lots 2 and 5

From: John Stainback, SPPRE

RE: **Executive Summary of Financial Analysis**

We have organized the Executive Summary of the Financial Analysis of the commercial development of Lots 2 and 5 into eight (8) sections, as follows:

- (Tab 2) The Four New Alternatives for Development Scenario C (Scenario C was selected by the Council Committee on August 25, 2004)
- (Tab 3) Building Program for the Recommended Development Scenario C-3
- (Tab 4) Overview of the Implementation Phasing Plan for Development Scenario C-3
- (Tab 5) A Summary of the C-3 Finance Models (5 Projects)
- (Tab 6) The Results of the Financial Sensitivity Analysis for Development Scenario C-3
- (Tab 7) The Recommended Public/Private Finance Plan for Development Scenario C-3
- (Tab 8) A Summary of the Nontax Income and Tax Revenue for the Town and Related Government Entities
- (Tab 9) Alternative Public/Private Finance Instruments for Affordable Housing

The Development of Lots 2 and 5 has evolved from the traditional commercial development of two underutilized Town-owned parking lots to five (5) development projects costing nearly $70 million. The five projects include:

- The Expansion of the Wallace Deck Garage into a Retail/Housing Development
- The Commercial Development of Lot 5 which Includes Retail, Housing and Underground Garage
- The Acquisition of the RBC Bank and development of a Public and Private-Use Garage with Retail At-Grade Level.

- The Development of the Transit Transfer Center on the Lot 2 Property
- The Commercial Development of Lot 2 which Includes Retail and Housing.

Overview of the Pre-development Process Completed to Date

Based on SPPRE's proven pre-development process, the Town has financed a market demand study (Step 4 of the SPPRE pre-development process) completed by Economic Research Associates (ERA). The results of this market demand study assures the Town that the proposed building program is market-driven, which is critically important to attract quality developers and for developers to eventually obtain the required equity and debt financing. This study has already proven to be important because it played a key role in the Land Appraisal of Lots 2 and 5. SPPRE converted the Market demand study into a Building Program (Step 5), which includes all of the building uses and land areas. In addition to completing the market demand study, the Town covered the cost of HKS Architects to complete Urban Design Plans for each development (Step 6).

Over the last several weeks, McDonald-York Construction Company completed a construction cost estimate for each development. The results of this cost estimate were incorporated directly into SPPRE's Total Development Budget for each of the five development projects (Step 7). In August and early September, SPPRE completed the Financial Analysis (Step 8) for four of the proposed projects (not the Transit Transfer Center (TTC)). Concurrently, with Step 8, SPPRE completed the Development Phasing Plan (Step 9), as well as the Public/Private Finance Plan (Step 10) for the five projects.

Section 1: The Four New Alternatives for Development Scenario C (Scenario C was selected by the Council Committee on August 25, 2004)

SPPRE has developed four alternative options for Development Scenario C, which was selected by the Council Committee at the conclusion of the August 25 work session. The purpose of this work is to provide the Council Committee with different options for Scenario C. After completing the Financial Analysis of C-3, we **highly recommend Option C-3**. This scenario allows the Town to move quickly and directly to implementation. Equally important, it allows the Town to concurrently develop Lot 5 and the expansion of the Wallace Deck, and also allows the Town to avoid the multiple risks of developing the RBC Garage in Phase 1 prior to any commercial development.

Section 2: Building Program for the Recommended Development Scenario C-3

The Total Building Program for the Five Projects includes:

The Total Building Program for the Five Developments includes:

Retail Space:	62,750 GSF
Market-Rate rental Housing:	305,440 GSF (244 units)
Affordable Housing:	76,360 GSF (61 units)
Subtotal:	444,550 GSF
Pedestrian Space:	55,100 GSF
Parking Garage Spaces:	
Private-Use:	709
Public-Use:	594
Total:	1,303 (92 spaces leased to developer)

The Expansion of the Wallace Deck (Phase 1)

Retail Space at Street Level:	4,000 GSF
Market-Rate Rental Housing:	109,120 GSF (87 Units)
Affordable Housing:	27,280 GSF (22 Units)
Pedestrian Space:	12,200 GSF
Parking Spaces:	400

Lot 5 Development (Phase 2)

Retail Space at Street Level:	30,250 GSF
Market-Rate Rental Housing:	128,480 GSF (102 Units)
Affordable Housing:	32,120 GSF (26 Units)
Pedestrian Space:	28,300 GSF
Parking Spaces:	553

Lot 2 Development (Phase 3B)

Retail Space at Street Level:	20,100 GSF
Market-Rate Rental Housing:	67,840 GSF (54 Units)
Affordable Housing:	16,960 GSF (14 Units)
Pedestrian Space:	14,600 GSF
Parking Spaces:	0

RBC Garage (Phase 3A)

Retail Space at Street level:	8,400 GSF
Parking Spaces:	258

Transit Transfer Center (Phase 3)

Street Level Space:	43,560 GSF

Section 3: An Overview of the Implementation Phasing Plan for Development Scenario C-3

The SPPRE Team will verbally present the Implementation Phasing Plan for all five projects on September 13, 2004.

Section 4: A Summary of the C-3 Finance Models

Overview of SPPRE's Approach to Structuring the Public/Private Finance Plans

For public partner clients, SPPRE always attempts to structure the financing to optimize private equity and debt investment. If the project is not financially feasible using traditional private equity and debt, then SPPRE uses it's arsenal of techniques to enhance cash flow and/or reduce development costs. If the project is still not financial feasible, SPPRE looks at ways for the public partner to invest, but using public finance instruments, which are supported solely by the proposed project. If and only if these project-backed public financing instruments are not feasible, does SPPRE turn to public partner debt requiring the full faith and credit of the primary public partner (Town of Chapel Hill). One of the requirements of the Town of Chapel Hill for this engagement is that the Town will not issue debt requiring the full faith and credit of the Town and negatively affecting the Town's debt capacity. For this engagement, SPPRE has avoided the use of Town debt, which relies on the Town's full faith and credit.

For this 5-Project assignment, SPPRE determined that traditional private equity and debt was not financially feasible, consequently we applied a multitude of techniques to enhance cash flow and reduce development costs. The following actions were applied to the Finance Models:

- Assumed the developer could obtain a construction loan with a Loan-to-Value of 85%.

- Reduced Base Rent to Town for Land Lease by one percent (1%)
- Eliminated all surplus public parking spaces in the garages.
- Eliminated residential storage units in the Wallace Deck and in the RBC Garage for Lot 2 housing
- Added retail space in the RBC Garage to generate nontax income and tax revenue for the Town
- Marginally reduced Base Rent to Town during the "Ramp-Up" years
- Marginally reduced Management Fees during the "Ramp-Up years.

By using these creative techniques, we were able to achieve the requirements of the current equity and debt capital markets. For example, the Internal Rate of Return (IRR) is in the low to high teens and the Return on Cost (ROC) is 8.5%, or higher.

See "Summary of Finance Models" on the next page of this Section.

Once we achieved these financial returns, we were able to begin testing whether the proposed Bond instruments could be supported 100% by the nontax income paid to the town by the private developer and tax revenue generated by the projects. (See Section 6 for the description of our recommended Public/Private Finance Plan.

Section 5: The Results of the Financial Sensitivity Analysis for Development Scenario C-3

Based on the current economic conditions in the U.S. and the escalating cost of construction and increasing interest rates, SPPRE has selected the following three finance and development variables to include in the Financial Sensitivity Analysis:

- Construction Cost
- Interest Rate
- Loan-to-Value

The Financial Sensitivity Analysis measures the effect of a variable Loan-To-Value (LTV), Interest Rate, and Construction Cost on the project's major performance measures including:

- Internal Rate of Return (IRR)
- Debt Service
- Return on Cost (ROC)
- Maximum Loan Amount
- Debt Coverage Ratio
- Cash Flow Before Taxes and Dividends (CFTBD)

From the spreadsheet, it is apparent that a rise in Construction Costs or Interest Rates on the projects return can seriously hamper the financial feasibility of the project from the perspective of the Private Partner. The rise or fall of these performance measures may require greater financial participation from the Public Partner. There are other Public/Private Finance methods that SPPRE can use to solve a shortfall that may result from this occurrence.

Section 6: The Recommended Public/Private Finance Plan for Development Scenario C-3

The driving force behind the proposed Public/Private Finance Plan is to structure the required Town investments so that each is supported solely by the nontax income paid to the Town by the private developer of each project and the tax revenue generated by each project. SPPRE has achieved this requirement. The cost of the following Town projects and transactions are financed with three types of Town-issued Bonds: 1) Lease Revenue Bonds, 2) Traditional Revenue Bonds, and 3) TIF-Backed Revenue Bonds.

Town projects required by the proposed public/private real estate partnership(s):

- Continue to Fund the Existing Revenue Bond for the Wallace Deck

- The Replacement Parking in the Lot 5 Development (173 spaces) and the Cost Delta of Below-grade parking versus Above-grade parking.

- Transit Transfer Center (TTC)

- The Town Garage on the RBC Property

Other major determinants of the Public/Private Finance Plan include development phasing, liquidity and type of nontax income to the Town.

The diagram on the next page graphically illustrates the sequence of events, sources of financing, financing instruments and project costs.

In a nutshell, the major components of the Public/Private Finance Plan include:

Part One: Continue funding the existing Revenue Bond for the existing Wallace Deck, yet start construction of Lot 5, thereby eliminating the existing income from Lot 5.

SPPRE achieved this by proposing that the commercial development of Lot 5 and Wallace Deck be completed concurrently. The existing income from Lot 5 generates $125,000 annually. We propose that the developer of Lot 5 be required to pay Construction Rent in the amount of $125,000 as part of the Land Lease transaction between the Town and the to-be-selected private developer. This construction rent is a one-time payment to the Town during the construction of Lot 5. Once construction of Lot 5 is completed, we are proposing to allocate 52% of the parking revenue of the 173 parking spaces in the Lot5 development owned by the Town. The projected net income from the 173 public parking spaces is $242,639. The town would use 52% of this annual income, or $125,000 to make-up the long-term loss of income from developing Lot 5.

When the development of Lot 2 begins, there will be a loss of income equal to $285,000, which is currently used by the town as part of the funds to support the existing Revenue Bond for the Wallace Deck. Our proposed finance plan uses two types of nontax income for the Town and the Property tax generated by the commercial development of the Wallace Deck to cover the $285,000 loss in income. The sources of Town nontax income and tax revenue includes:

- Property Tax generated by the private portion of the Wallace Deck: $107,585
- The annual Base Rent paid by the private developer as part of the Land Lease transaction: $119,180.
- The annual lease payments of $38,640 paid by the developer for the use of 92 parking spaces required by the new housing units over the Wallace Deck.

The total nontax income and Property Tax is equal to: $265,405.

Part Two: Finance the Town's Portion of the Underground Garage on Lot 5 to Accommodate the 173 Replacement Parking Spaces for the Existing Lot 5 and the Delta Cost of developing Parking Underground Versus Above-grade Parking.

Under the proposed Public/Private Finance Plan, the town will be responsible for two costs to implement the commercial development of Lot 5: 1) The development cost of the 173 replacement parking spaces, which totals $2,955,621, and 2) The difference in developing parking spaces below-grade and above-grade. As described to the Council Committee in earlier meetings, we anticipate that the to-be-selected developer will not want to incur the significant additional cost of providing parking below-grade versus the more typical cost of developing an above-grade garage. SPPRE completed the Proforma assuming that the private developer financed the underground garage, but the return on investment did not meet the current requirements of the equity and debt capital markets.

Part two of the proposed Public/Private Finance Plan includes the solution for the Town to finance the $4,610,494 cost of the replacement parking and the cost delta of below-grade and above-grade garages. The solution includes two public finance instruments: 1) A lease Revenue Bond supported 100% by nontax income and 2) A TIF-Backed Revenue Bond supported 100% by the Property Tax generated by the commercial development of Lot 5.

1) Lease Revenue Bond

The proposed Lease Revenue Bond is supported by two sources of income to the Town: a) 48% of the Net Income from the 173 public parking spaces equal to $116,467, and b) The Base rent paid by the private developer to the Town as part of the Land Lease of the Lot 5 property. This annual payment to the Town is $252,000.
The total nontax income used to support the Lease Revenue Bond is $368,467.

This amount of annual income can support a Revenue Bond in the amount of $4,226,568 including the following assumptions:

Term: 30 years
Coupon Rate: 6.0%
Debt Service Coverage Ratio: 1.20

2) TIF-Backed Revenue Bond

The annual Property Tax generated by the proposed commercial development of Lot 5 in stabilized year 5 totals: $169,190.

This amount of annual income can support a TIF-Backed Revenue Bond in the amount of $1,940,726 including the following assumptions:

Term: 30 years
Coupon Rate: 6.0%
Debt Service Coverage Ratio: 1.20

The $6,167,294 cumulative amount of the proposed TIF-Backed Revenue Bond and the Lease Revenue Bond more than covers the $4,610,494 cost of the 173 underground public parking spaces and the delta cost of the underground parking versus the above-grade parking which would be acceptable to the typical private developer for an urban site such as Lot 5

Part Three: The Finance of the Transit Transfer Center (TTC)

The Public/Private Finance Plan for the Transit Transfer Center (TTC) is presented as an option for the Council Committee's consideration. This proposed financing allows the Town to avoid the uncertainties of obtaining funding for the TTC, which in turn allows the Town to accelerate the development of Lot 2.

We propose to use the nontax income and tax revenue generated by the commercial development of Lot 2 to cover 100% of the debt service required to finance the TTC.

1) Lease Revenue Bond

   The proposed Lease Revenue Bond is supported 100% by the Base Rent paid by the private developer to the Town as part of the Land Lease of the Lot 2 property.

   This annual payment to the Town is $128,000.

   This amount of annual income can support a Revenue Bond in the amount of $1,468,248 including the following assumptions:

   Term: 30 years
   Coupon Rate: 6.0%
   Debt Service Coverage Ratio: 1.20

2) TIF-Backed Revenue Bond

   The annual Property Tax generated by the proposed commercial development of Lot 2 in stabilized year 5 totals: $83,824.

   This amount of annual income can support a TIF-Backed Revenue Bond in the amount of $961,519 including the following assumptions:

   Term: 30 years
   Coupon Rate: 6.0%
   Debt Service Coverage Ratio: 1.20

   The $2,429,767 cumulative amount of the proposed TIF-Backed Revenue Bond and the Lease Revenue Bond covers the estimated $2,141,037 cost of the proposed TTC located at the base of the Lot 2 development.

Part Four: The Finance of the Public Garage Located on the RBC Property

Under Development Scenario C-3, the RBC Garage includes the 101 replacement parking spaces currently included on Lot 2. Initially, the RBC Garage was needed in Phase 1 in order to accommodate the 274 replacement parking spaces required to start construction of Lots 2 and 5. As the Council Committee knows, SPPRE was concerned about the potential risk the Town could incur if the RBC Garage was developed prior to any commercial development occurs or prior to closing an agreement with the RBC Centura Bank.

The proposed Public/Private Finance Plan for the Town Garage on the RBC Property includes a traditional Revenue Bond supported 100% by the Town's net parking income, which also includes a long-term lease of 140 parking spaces by the developer of Lot 2.

The Revenue Bond issued by the Town would be supported solely by net income totaling \$378,559. This amount of annual net income can support a Revenue Bond amount equal to \$4,342,333, assuming a term of 30 years, a Coupon Rate of 6.00%, and a Debt Service Coverage Ratio of 1.20. This Bond covers the estimated \$3,277,518 cost of the RBC Garage.

Section 7: A Summary of the Nontax Income and Tax Revenue for the Town and related Government Entities

There are four government entities that will share the economic benefits of the development of Lots 2 and 5 and the Wallace Deck: 1) The Town of Chapel Hill, 2) Orange County, 3) The Chapel Hill/Carrboro School District, and 4) The State of North Carolina. We have organized the economic benefits of this project into Non-Tax Income and Tax Revenue, as follows:

Nontax Income

All of the Nontax Income is paid to the Town of Chapel Hill. The Nontax Income includes:

- Construction Rent as part of the Land Lease with the to-be-selected developer

  As part of the proposed Land Lease Agreement we will require the developer to pay rent during construction. It was determined that this was only possible on the development of Lot 5. The total rent paid is \$125,000.

- Base Rent and Indexed Rent as part of the Land Lease with the to-be-selected developer

  As part of the proposed Land Lease Agreement we will require the developer to pay a base rent that has been indexed to the 2004 Consumer Price Index (CPI). The three proposed projects generate the following nontax income for the Town

- Wallace Deck Expansion: $3,863,213
- Lot 5 Development: $8,092,956
- Lot 2 Development: $4,149,108

The total base rent paid to the Town from years 1 – 30 is $16,105,277.

- Participation in the Net Sales Proceeds

  As part of the proposed Land Lease Agreement we will require the developer to allow the Town to have a 10% position when any building is sold to a third party. We have assumed that each project below will be sold in Year 10.

  - Wallace Deck Expansion: $841,100
  - Lot 5 Development: $1,004,127
  - Lot 2 Development: $694,911

  The total Net Sales Proceeds for the Town equals $2,540,138.

  Clearly, at this point in time, no one knows when the buildings will be sold, if ever, but many developers do sell their buildings between Years 5 and 10. This type of Land Lease Payment allows the Town to participate in the appreciation of the development value and corresponding "upside".

Tax Revenue

Tax Revenue generated by the proposed projects has been organized into Property Tax and Sales Tax.

Property Tax

The proposed three private developments (Lot 5, Lot 2, and the expansion of the Wallace Deck) generate the following amounts of property tax in Years 1 – 30:

- Orange County: $19,640,171
- Chapel Hill/Carrboro School District: $4,463,675
- Chapel Hill City Revitalization: $12,833,066
- Downtown Revitalization District: $1,383,739

Because SPPRE leveraged these property taxes on behalf of the Town, we have totaled the taxes into the following categories:

- County and School District: $24,103,846

- Total Town Property Tax: $14,216,805

The total property tax generated by the proposed projects in years 1 – 30 equals $38,320,651.

Sales Tax

Based on the Retail Building Program and the $330 in sales per S.F. as quoted by the International Council of Shopping Centers (ICSC), we have determined that the proposed development projects will generate Sales Tax in years 1 – 30 as follows:

- State of North Carolina: $22,275,891
- Orange County: $12,375,495

The total Sales Tax generated in years 1 – 30 equals $34,651,386.

The total tax revenue generated by the proposed projects over years 1 – 30 equals $72,972,038.

Section 8: Alternative Public/Private Finance Instruments for Affordable Housing

The SPPRE team will identify alternative financing instruments for Affordable Housing for the September 13, work session.